Chapter 11 **Forfaiting**

orfaiting is a method of trade finance that allows exporters to obtain cash by selling their medium and long-term foreign accounts receivable at a discount on a "without recourse" basis. A forfaiter is a specialized finance firm or a department in a bank that performs non-recourse export financing through the purchase of medium and long-term trade receivables. "Without recourse" or "non-recourse" means that the forfaiter assumes and accepts the risk of non-payment. Similar to factoring, forfaiting virtually eliminates the risk of non-payment, once the goods have been delivered to the foreign buyer in accordance with the terms of sale. However, unlike factors, forfaiters typically work with exporters who sell capital goods and

commodities, or engage in large projects and therefore need to offer extended credit periods from 180 days to seven years or more. In forfaiting, receivables are normally guaranteed by the importer's bank, which allows the exporter to take the transaction off the balance sheet to enhance key financial ratios. The current minimum transaction size for forfaiting is \$100,000. In the United States, most users of forfaiting are large established corporations, but small and medium-size companies are slowly embracing forfaiting as they become more aggressive in seeking financing solutions for exports to countries considered high risk.

Key Points

- Forfaiting eliminates virtually all risk to the exporter, with 100 percent financing of contract value.
- Exporters can offer medium and long-term financing in markets where the credit risk would otherwise be too high.
- Forfaiting generally works with bills of exchange, promissory notes, or a letter of credit.
- In most cases, the foreign buyers must provide a bank guarantee in the form of an aval, letter of guarantee or letter of credit.
- Financing can be arranged on a one-shot basis in any of the major currencies, usually at a fixed interest rate, but a floating rate option is also available.
- Forfaiting can be used in conjunction with officially supported credits backed by export credit agencies such as the U.S. Export-Import Bank.

CHARACTERISTICS OF FORFAITING

Applicability

Suited for exports of capital goods, commodities, and large projects on medium and long-term credit (180 days to seven years or more)

Risk

Risk of non-payment inherent in an export sale is virtually eliminated

Pros

- Eliminates the risk of non-payment by foreign buyers
- Offers strong capabilities in emerging and developing markets

Cons

- Cost is often higher than commercial lender financing
- Limited to medium and long-term transactions and those exceeding \$100,000

How Forfaiting Works

The exporter approaches a forfaiter before finalizing the transaction's structure. Once the forfaiter commits to the deal and sets the discount rate, the exporter can incorporate the discount into the selling price. The exporter then accepts a commitment issued by the forfaiter, signs the contract with the importer, and obtains, if required, a guarantee from the importer's bank that provides the documents required to complete the forfaiting. The exporter delivers the goods to the importer and delivers the documents to the forfaiter who verifies them and pays for them as agreed in the commitment. Since this payment is without recourse, the exporter has no further interest in the financial aspects of the transaction and it is the forfaiter who must collect the future payments due from the importer.

When to Contact a Forfaiter

Forfaiting is widely used by exporters and financial institutions throughout Europe because their sales and financing professionals work very closely together to develop a contract price proposal that makes the cost of financing competitive and attractive to foreign buyers, an approach not widely embraced and practiced in the United States. Thus, exporters should contact a forfaiter at the earliest possible point in formulating their sales and financing proposals so that they might better understand the subtleties and complexities of dealing in certain markets, including how to create a medium-term financing proposal at interest rates that are competitive, without reducing the margin on the sale.

Cost of Forfaiting

The cost of forfaiting to the exporter is determined by the rate of discount based on the aggregate of the LIBOR (London inter bank offered rate) rates for the tenor of the receivables and a margin reflecting the risk being sold. In addition, there are certain costs that are borne by the importer that the exporter should also take into consideration. The degree of risk varies based on the importing country, the length of the loan, the currency of the transaction, and the repayment structure—the higher the risk, the higher the margin and therefore the discount rate. However, forfaiting can be more cost-effective than traditional trade finance tools because of the many attractive benefits it offers to the exporter.

Three Additional Major Advantages of Forfaiting

Volume: Forfaiting can work on a one-off transaction basis, without requiring an ongoing volume of business. **Speed:** Commitments can be issued within hours or days depending on details and country. **Simplicity:** Documentation is usually simple, concise, and straightforward.

Forfaiting Industry Profile

Forfaiting was developed in Switzerland in the 1950s to fill the gap between the exporter of capital goods, who would not or could not deal on open account, and the importer, who desired to defer payment until the capital equipment could begin to pay for itself. Although the number of forfaiting transactions is growing worldwide, there are currently no official statistics available on the size of the global forfaiting market. However, industry sources estimate that the total annual volume of new forfaiting transactions is around \$30 billion and that forfaiting transactions worth \$60 to \$75 billion are outstanding at any given time. Industry sources also estimate that only 2 percent of world trade is financed through forfaiting. U.S. forfaiting transactions account for only 3 percent of that volume. Forfaiting firms have opened around the world, but the Europeans maintain a hold on the market, including in North America. Although these firms remain few in number in the United States, the innovative financing they provide should not be overlooked as a viable means of export finance for U.S. exporters.

Where to Find a Forfaiter

The Association of Trade & Forfaiting in the Americas, Inc. (ATFA) and the International Forfaiting Association (IFA) are useful sources for locating forfaiters willing to finance exports. ATFA and IFA are associations of financial institutions dedicated to promoting international trade finance through forfaiting. ATFA is located in New York, and its Web site is *www.tradeandforfaiting.com*. IFA is located in Switzerland and its Web site is *www.forfaiters.org*.